SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Corbett et. al. Analyst: Marion Mann DeJong Bill Number: AB 2596

Related Bills: See Prior Analysis Telephone: 845-6979 Amended Date: ____________

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Manufacturers' Investment Credit/Extends to Electric Power Generation

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO ________________________.

_____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ___________ STILL APPLIES.

__X__ OTHER - See comments below.

SUMMARY OF BILL

This bill would modify the Manufacturers' Investment Credit (MIC) to include taxpayers engaged in businesses relating to fossil fuel electric power generation. The business activities of these taxpayers are described in North American Industry Classification System (NAICS) Manual Code 221112.

SUMMARY OF AMENDMENT

The April 3, 2000, amendments reinserted the limited carryover provision that the bill as introduced would have removed and replaced it with the provisions discussed in this analysis.

The department's analysis of the bill as introduced no longer applies.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment. The bill specifies that it would apply to taxable or income years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

SB 1920 would add businesses relating to "other" electric power generation to the MIC. These businesses are described in NAICS Code 221119.

AB 2461 would add business relating to certain electric power production to the MIC. These businesses are described in Standard Industrial Classification Manual (SIC) Code 4911.

Board Position:			Legislative Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Brian Putler for JLR	4/18/00
_____ N	_____ OUA	__X__ PENDING		

SPECIFIC FINDINGS

Existing state law allows qualified taxpayers a manufacturers' investment credit equal to 6% of the amount paid or incurred after January 1, 1994, for qualified property that is placed in service in California.

For purposes of the MIC, a qualified taxpayer is any taxpayer engaged in manufacturing and certain related activities described in specified codes in the SIC Manual. Qualified property is any of the following:

1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code (IRC) and used primarily:

- for manufacturing, processing, refining, fabricating or recycling of property;
- for research and development;
- for the maintenance, repair, measurement, or testing of otherwise qualified property; or
- for pollution control which meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) Special purpose buildings and foundations that are an integral part of specified activities.

For taxpayers engaged in computer programming and computer software related activities, qualified property includes computers and computer peripheral equipment used primarily for the development and manufacture of prepackaged software, and the value of any capitalized labor costs directly allocable to such property.

The MIC provides a variety of special rules for costs paid pursuant to a binding contract and leased property. The credit may be carried over until exhausted, for a maximum of eight years. For small businesses, this carryover period is extended to ten years. The taxpayer must recapture any credit previously allowed if the property is removed from California, disposed of to an unrelated party or converted to an unauthorized use within one year from the date the property is first placed in service in California.

This bill would modify the definition of qualified taxpayer to include businesses relating to fossil fuel electric power generation. These businesses are described in NAICS Manual Code 221112, as follows:

> Establishments primarily engaged in operating fossil fuel powered electric power generation facilities. These facilities use fossil fuels, such as coal, oil, or gas, in internal combustion or combustion turbine conventional steam process to produce electric energy. The electric energy produced in these establishments is provided to electric power transmission systems or to electric power distribution systems.

This bill would modify the definition of qualified property to include tangible personal property, and capitalized labor costs for constructing such property, used by the taxpayer in fossil fuel electric power generation businesses. In addition, qualified property would include special purpose buildings and foundations, including capitalized labor costs for constructing such buildings or foundations, for taxpayers engaged in fossil fuel electric power generation activities.

This bill also would modify the definition of "manufacturing" to include the generation of electricity.

Policy Considerations

This bill would benefit transactions for which binding contracts already exist and would not be limited to benefit only future business decisions. Contracts in electric power generation transactions entered into after January 1, 1994, but prior to enactment of this bill, would qualify for the credit.

This bill would expand the definition of manufacturing to include the generation of electricity. As a result, taxpayers who qualify for the MIC under existing law could claim the MIC for auxiliary activities that satisfy this expanded definition of manufacturing. For example, assume a manufacturing plant that includes on its premises a co-generation facility that produces electricity to run the manufacturing line. Under current law, this co-generation facility is properly treated as an auxiliary establishment under the SIC Manual and is assigned the same SIC Code as the manufacturing activity. However, since the generation of electricity is not a qualified activity for MIC purposes under existing law, the costs attributable to the co-generation facility would not qualify for the MIC. However, such activities would qualify under the manufacturing definition provided by this bill.

Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the department's normal annual update.

It is unclear under current law whether electricity constitutes "tangible personal property" so that the general manufacturing process definitions under the statute are applicable. It may be advisable to provide a specific definition of the manufacturing process for electricity to determine the points at which the manufacturing process begins and when the property has been altered into its completed form to avoid disputes between taxpayers and the department.

Technical Considerations

Amendments 1 through 4 would remove the phrase "the act adding this subdivision" and insert the correct citation for the specific laws that changed the MIC.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

The revenue impact of this bill, under the assumptions discussed below, is estimated to be as follows:

Revenue Impact of AB 2596 as amended 04/03/2000		
For Taxable/Income Years Beginning 1/1/2000		
Assumed Enactment After 6/30/2000		
Fiscal Years		
(In Millions)		
2000-01	2001-02	2002-03
-$4	-$6	-$7

This analysis, does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Tax Revenue Discussion

The revenue impact of this credit would depend on the amount of qualified costs incurred and the tax liability of qualified taxpayers.

Qualified costs were estimated from an U.S. Census Bureau survey of capital expenditures by the industries in SIC codes 4911, 4931 for 1997. Qualified costs were then factored down to reflect NAICS Code 221112, which is an industry subgroup of the above SIC codes. The 1997 numbers were grown to approximate 2000 and beyond. The credit use rates, taken from the microsimulation model of California tax returns, were then applied to derive the aggregate credit use. The fiscal year cash flow patterns are based on our analysis of how manufacturers adjusted their tax payments to reflect the reduction in liability resulting from the current law MIC.

This estimate does not include losses resulting from qualified taxpayers as defined under current law that might receive additional credit for activities that would qualify under the definition of manufacturing provided by this bill. Such losses cannot be quantified since the taxpayers engaged in the production of electricity, but whose primary business is manufacturing, cannot be identified.

BOARD POSITION

Pending.

Marion Mann DeJong
845-6979
Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2596
As Amended April 3, 2000

AMENDMENT 1

On page 15, modify lines 11 and 12 as follows:

(j) The amendments made by ~~the act adding this subdivision~~ Chapter 954 of the Statutes of 1996 shall be operative for taxable years beginning

AMENDMENT 2

On page 15, modify lines 15 and 16 as follows:

(k) The amendments made by ~~the act adding this subdivision~~ Chapter 323 of the Statutes of 1998 shall be operative for taxable years beginning

AMENDMENT 3

On page 28, modify lines 23 and 24 as follows:

(j) The amendments made by ~~the act adding this subdivision~~ Chapter 954 of the Statutes of 1996 shall be operative for income years beginning

AMENDMENT 4

On page 28, modify lines 27 and 28 as follows:

(k) The amendments made by ~~the act adding this subdivision~~ Chapter 323 of the Statutes of 1998 shall be operative for income years beginning